



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-120927-13]

RIN-1545-BL61

Treatment of Income from Indian Fishing Rights-Related Activity as Compensation

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would clarify that amounts paid to an Indian tribe member as remuneration for services performed in a fishing rights-related activity may be treated as compensation for purposes of applying the limits on qualified plan benefits and contributions. These regulations would affect sponsors of, and participants in, employee benefit plans of Indian tribal governments.

DATES: Comments and requests for a public hearing must be received by

[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-120927-13), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington D.C. 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-120927-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W.,

Washington, DC, 20224, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-120927-13).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Sarah Bolen or Pamela Kinard at (202) 622-6060 or (202) 317-6700; concerning the submission of comments or to request a public hearing, Oluwafunmilayo Taylor, (202) 622-7180 or (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Indian tribal governments (ITGs) and individual tribe members conduct fishing activities to generate revenue, protect critical habitats, and preserve tribal customs and traditions. Various treaties, federal statutes, and Presidential executive orders reserve to Indian tribe members the right to fish for subsistence and commercial purposes both on and off reservations. Because many of the treaties, statutes, and executive orders were adopted before passage of the Federal income tax, they often do not expressly address the question of whether income derived by Indians and ITGs from protected fishing activities is exempt from taxation. See H.R. Rep. 100-1104, at p. 77 (1988).

Congress added section 7873 to the Internal Revenue Code as part of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647). Section 7873(a)(1) provides that no income tax shall be imposed on income derived from a fishing rights-related activity of an Indian tribe by (A) a member of the tribe directly or through a qualified Indian entity, or (B) a qualified Indian

entity. Section 7873(a)(2) provides that no employment tax shall be imposed on remuneration paid for services performed in a fishing rights-related activity of an Indian tribe by a member of such tribe for another member of such tribe or for a qualified Indian entity. Thus, section 7873(a) exempts income derived from a fishing rights-related activity (“fishing rights-related income”) from both income and employment taxes.

Section 7873(b)(1) defines fishing rights-related activity with respect to an Indian tribe as any activity directly related to harvesting, processing, or transporting fish harvested in the exercise of a recognized fishing right of the tribe or to selling such fish but only if substantially all of such harvesting was performed by members of such tribe.

Section 415(a)(1) provides that a trust that is part of a pension, profit-sharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if (A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceed the limitation of section 415(b), or (B) in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitation of section 415(c).

Section 415(b)(1) provides that benefits with respect to a participant exceed the annual limitation for defined benefit plans if, when expressed as an annual benefit (within the meaning of section 415(b)(2)), the participant’s annual benefit is greater than the lesser of \$160,000 (as adjusted in accordance with

section 415(d)(1)) or 100 percent of the participant's average compensation for the participant's high 3 years.

Section 415(b)(3) provides that, for purposes of section 415(b)(1), a participant's high 3 years will be the period of consecutive calendar years (not more than 3) during which the participant had the greatest aggregate compensation from the employer. In the case of an employee within the meaning of section 401(c)(1) (that is, a self-employed individual treated as an employee), the preceding sentence is applied by substituting for "compensation from the employer" the following: "the participant's earned income (within the meaning of section 401(c)(2) but determined without regard to any exclusion under section 911)."

Section 415(c)(1) provides that contributions and other additions with respect to a participant exceed the annual limitation for defined contribution plans if, when expressed as an annual addition (within the meaning of section 415(c)(2)) to the participant's account, the participant's annual addition is greater than the lesser of \$40,000 (as adjusted in accordance with section 415(d)(1)) or 100 percent of the participant's compensation. Section 415(c)(3) provides that the term "participant's compensation" means the compensation of the participant from the employer for the year. Section 1.415(c)-2(a) of the Income Tax Regulations generally provides that compensation from the employer within the meaning of section 415(c)(3) includes all items of remuneration described in §1.415(c)-2(b), but excludes the items of remuneration described in §1.415(c)-2(c).

Section 1.415(c)-2(b) generally provides that, for purposes of applying the limitations of section 415, the term compensation means remuneration for services. Specifically, under §1.415(c)-2(b)(1), compensation includes employee wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan, to the extent that the amounts are includible in gross income. In addition, §1.415(c)-2(b)(2) provides that in the case of an employee within the meaning of section 401(c)(1) (a self-employed employee), compensation includes the employee's earned income (as described in section 401(c)(2)) plus amounts deferred at the election of the employee that would be includible in gross income but for the rules of section 402(e)(3), 402(h)(1)(B), 402(k), or 457(b).

Section 1.415(c)-2(c) excludes certain items from the definition of compensation under section 415(c)(3). Specifically, §1.415(c)-2(c)(1) excludes contributions (other than certain elective contributions) made by the employer to a plan of deferred compensation to the extent that the contributions are not includible in the gross income of the employee for the taxable year in which contributed. Likewise, distributions from plans (whether qualified or not) are generally not considered to be compensation for section 415 purposes. Section 1.415(c)-2(c)(2) excludes from compensation amounts realized from the exercise of nonstatutory options and amounts realized when restricted stock or other property held by an employee becomes freely transferable or is no longer subject

to a substantial risk of forfeiture. Section 1.415(c)-2(c)(3) excludes from compensation amounts realized from the sale, exchange, or other disposition of stock acquired under a statutory stock option (as defined in §1.421-1(b)). Finally, §1.415(c)-2(c)(4) excludes from compensation other amounts that receive special tax benefits, such as certain premiums for group-term life insurance.

Section 1.415(c)-2(d) provides safe harbor definitions that a plan is permitted to use to define compensation in a manner that satisfies section 415(c)(3). Section 1.415(c)-2(d)(2) provides a safe harbor definition of compensation that includes only those items listed in §1.415(c)-2(b)(1) or (b)(2) and excludes all the items listed in §1.415(c)-2(c). Section 415(c)-2(d)(3) provides a separate safe harbor definition of compensation that includes wages within the meaning of section 3401(a), plus amounts that would be included in wages but for an election under section 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(b), 402(k), or 457(b).

Explanation of Provisions

Because fishing rights-related income is not subject to income tax, an issue has been raised as to whether such income is included as compensation for purposes of section 415(c)(3) and §1.415(c)-2(b). The proposed regulations would clarify that certain fishing rights-related income is included in the definition of compensation. Specifically, these regulations would provide that amounts paid to a member of an Indian tribe as remuneration for services performed in a fishing rights-related activity (as defined in section 7873(b)(1)) do not fail to be treated as compensation under §1.415(c)-2(b)(1) and (b)(2) (and are not

excluded from the definition of compensation pursuant to §1.415(c)-2(c)(4)) merely because those amounts are not subject to income tax as a result of section 7873(a)(1). Thus, the determination of whether an amount constitutes wages, salaries, or earned income for purposes of §1.415(c)-2(b)(1) or (b)(2) is made without regard to the exemption from taxation under section 7873(b)(1) and (b)(2). In addition, by permitting fishing rights-related income to be treated as wages, salaries, or earned income under §1.415(c)-2(b)(1) and (b)(2), plans that accept contributions of fishing rights-related income would not be precluded from utilizing the safe harbor definitions of compensation under §1.415(c)-2(d)(2) and (d)(3) of the regulations.

Proposed Applicability Date

These regulations are proposed to apply for taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers, however, may rely on these proposed regulations for periods preceding the effective date, pending the issuance of final regulations. If, and to the extent, the final regulations are more restrictive than the rules in these proposed regulations, those provisions of the final regulations will be applied without retroactive effect.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that 5 U.S.C. 533(b) of the

Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply and a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Office of Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. In addition to general comments on the proposed regulations, the IRS and the Treasury Department request comments on the taxation of qualified plan distributions that are attributable to fishing rights-related income, and the application of section 72(f)(2) (which treats certain amounts as basis for purposes of computing employee contributions if those amounts would have not been includible in income had they been paid directly to the employee). All comments are available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the public hearing will be published in the **Federal Register**.

Consultation and Coordination with Indian Tribal Governments

These proposed regulations take into account comments provided through a number of general consultation sessions held with the Indian tribal community in recent years. Consistent with Executive Order 13175, the Treasury Department and the IRS expect to hold a telephone consultation on a date between **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]** and **[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. This telephone consultation session will focus principally on the contribution of section 7873 income to qualified retirement plans and the taxation of qualified plan distributions that are attributable to this income. Information relating to the consultation, including the date, time, registration requirements, and procedures for submitting written and oral comments, will be available on the IRS website relating to Indian tribal governments at: <http://www.irs.gov/Government-Entities/Indian-Tribal-Governments>.

Drafting Information

The principal author of these regulations is Sarah R. Bolen, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

List of subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.415(c)-2 is amended by adding paragraphs (g)(9) and (h) to read as follows:

§1.415(c)-2 Compensation.

* * * * *

(g) * * *

(9) Income derived by Indians from exercise of fishing rights. Amounts paid to a member of an Indian tribe directly or through a qualified Indian entity (within the meaning of section 7873(b)(3)) as compensation for services performed in a fishing rights-related activity (as defined in section 7873(b)(1)) of the tribe do not fail to constitute compensation under paragraphs (b)(1) and (b)(2) of this section and are not excluded from the definition of compensation pursuant to paragraph (c)(4) of this section merely because those amounts are not subject to income or employment taxes as a result of section 7873(a)(1) and (2). Thus, the determination of whether an amount constitutes wages, salaries, or earned income for purposes of paragraph (b)(1) or (a)(2) of this section is made without regard to the exemption from taxation under section 7873(a)(1) and (2).

(h) Effective/applicability date. Section 1.415(c)-2(g)(9) shall apply for plan years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Heather C. Maloy
Acting Deputy Commissioner for Services and Enforcement.

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